



# Global High Conviction Portfolio

Individually Managed Account

## Monthly Update

April 2019

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# Global High Conviction Portfolio Update

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## Portfolio & Market Update

Equity markets rose again in April and the S&P 500 is now up almost 18% since the start of the year. This compares to an average annual return of around 10% in the last 80 years. Other equity markets rose but by less. We have remained fully invested during this period of high volatility and have made some changes to the portfolio.

USA earnings have been reasonably strong with some notable exceptions. The belief that the Federal Reserve has 'pivoted' and done a 'volte face' on interest rates has also helped.

We are not so sure that interest rates are the only variable to monitor in assessing monetary conditions. The large size and varied composition of the Federal Reserve balance sheet is still sufficient for them to tweak monetary policy tighter if the USA economy gathers more momentum.

After a strong run we anticipate a more reflective period but "sell in May and go away" is probably the wrong stance.

Results were good for the strategy except for Intel which guided revenues lower in its Data Centre division for the rest of the year. The company's shares fell more than 10% after being up about 25% YTD midway through the month.

Our new position in Sony rose strongly. The announcement by Disney of its DIS+ platform which will initially be priced to complement other subscriptions, e.g. Netflix, has highlighted the importance of content which Sony has in abundance.

We also sold Apple after its strong return to favour and purchased a new position in Discovery Channel which specialises in 'non scripted' content.

Discovery Channel owns National Geographic, Travel Channel and Animal Planet and similar 'educational' programme channels. During the month they announced deals with BBC Studio Network and YouTube, which is Google's streaming platform rival to Netflix. There will be multiple streaming channels to rival Netflix. With the cost of scripted content (aka Drama) rising strongly we believe back catalogues and cheaper non scripted 'educational' shows will be in high demand. Discovery is highly cash generative with a rapidly improving balance sheet on modest multiples.

Sentiment in China and Japan continues to improve and we remain confident in Asian prospects.

**So where can I find a company making a profit; paying a dividend; on a reasonable valuation and yet not have to give up being part of the '4th Industrial Revolution'?**

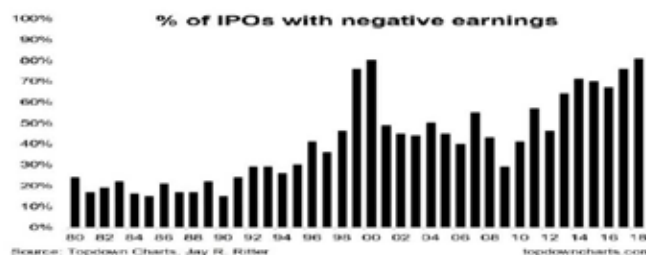
If 50 is the new 40, then is negative the new positive?

We ask this in the light of 2 recent Initial Public Offerings (IPOs) where neither company has made a profit, is not about to make a profit, and is quite possibly never going to make a profit. We are of course referring to Lyft and Uber – the ride companies with other bits added.

Regardless of this apparently small problem over profitability, the companies were initially capitalised at c. \$US25bn for Lyft and c. \$US80bn for Uber. Both are less valuable than this now but investors are clearly 'pretty relaxed' about the long term prospects with price to sales ratios at over 6x for both. To put that into perspective the S&P 500 trades on about 2x price to sales.

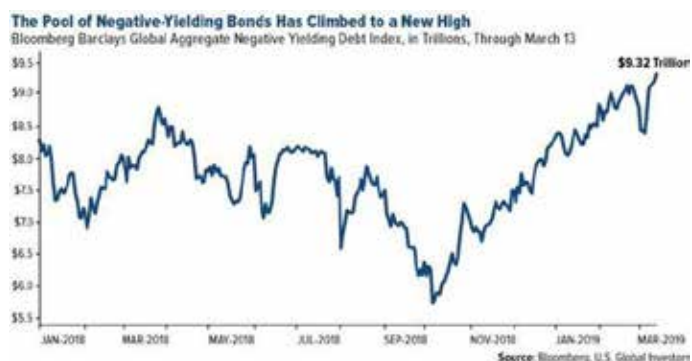
There has been a trend recently toward more IPOs with negative earnings and we show a chart below which ought to give pause for thought. How come investors again don't care about investing hard earned savings into loss making entities? Cynically we note that the Private Equity pools need to recycle capital and will be wanting to exit investments made about a decade ago, and are perfectly capable of working with Wall Street to get junk and unready companies into the marketplace. It's been done many times. Caveat emptor.

Nonetheless, we are at levels of 'irrational exuberance' in some parts of the stock-market where we were in 1999/2000. Remember what happened next?



Just because equity investors can be overly optimistic doesn't mean that bond investors don't know how to make some apparently weird decisions too? See below for the size of the bond pool where negative yields are 'on offer'. About 16% of the outstanding government bond universe now has a negative yield!

To be clear, a negative yield is where you will definitely get a lower face value back at redemption than you lent to the borrower and you PAY the borrower for the privilege of parking YOUR money with them. It is of course possible to lose money on a positive yield bond investment where maturity at 100% is lower than you might have paid, but pretty whacky to have to pay interest to the borrower than the other way around? So what is going on?





Negative yields only occur in bond markets where investors are very nervous; the borrower is of the highest quality; and investors are happy with a return of capital rather than a return on capital. The rapid growth of the negative yielding pool would indicate that many investors are now more nervous of investing with riskier borrowers and/or being driven into these bonds by monetary policy and indexing pressures?

So if bond investors are getting more nervous, how come equity investors are getting 'more relaxed'?

Maybe the deliberate ploy by central banks to force investors into riskier assets including loss making equities, by making safe investments such as bonds, less attractive, is having an impact and 'risk on' in buying any (loss making) equity regardless of valuation is now a default setting? "If bonds are REALLY expensive then let's take lots of risk in equities especially ones with growth"?

We think as a default setting it's gone too far and use the chart below to show just how stretched is the return relationship between Value equities and Growth equities. This is from the USA but also applies globally.

(Full disclosure – we are more Value oriented and prefer dividends to no dividends because of the time value of money, and have hung on grimly while the excess returns of momentum strategies get wider! So we would like this particular frenzy to come to an end!)



**KLA Tencor**



We often get criticised for our Value bias on the basis that we don't understand we are at the start of the 4th industrial revolution and growth and innovation matters more than profits and dividends from 'dying companies'.

Our response is that we can and do invest in new technology, just not at high prices, and we can also find companies with profits and dividends too. (see our article on 'What technology means to us')

How then do we protect ourselves from a sudden reversal away from 'risk on' momentum investing styles, and yet participate in continued change and new opportunities? It's simple really. Find misunderstood companies on lower multiples which pay a dividend as proof of profits and share-holder respect! There are quite a few of them.

A brief description of a recent purchase of KLA Tencor can illustrate? We think investing in this type of company is far better than punting on loss making entities at IPO or even buying negative yielding bonds no matter how safe they appear

to be or how much of the index they represent.

(We also own Hitachi High Technologies which operates in a related tech space to KLAC, so 'high conviction' seems an appropriate name for our global equity strategy where we only have 30 stocks?)

KLA-Tencor Corp. (KLAC) is the leading supplier of process control equipment used in the fabrication of integrated circuits. Integrated circuits are small chips that perform functions in the digital world such as memory storage, timers for automated processes, amplifiers etc. Before they get installed they need to be tested that they work. KLA Tencor focusses on this testing. Process control systems in which KLA Tencor specialise, are used to analyse product and process quality at critical junctures (mostly the back end when the whole IC Package has been assembled) of the manufacturing process. Small increases in yields, the % of the IC package that works, are very valuable to the semi makers since this means huge increases in profits to them. KLAC was formed in April 1997, when KLA merged with Tencor Corporation to become the single largest provider of process control equipment in the world. Recently they acquired Orbotech from Israel which cements this position and diversifies the product line-up. Market share is in excess of 70% so as dominant in this space as Google is/was in online ads? The global market is probably above \$6bn and growing so a 70% share is worth over \$4bn in revenue.

The challenge is that the market and pricing of ICs and the testing equipment is cyclical around a long term growth rate and the companies can be both financially and operationally leveraged to this cycle. Consequently it pays to invest while the news flow is not great but as best you can predict, the trough in operating profitability has been reached. The current news is indeed not great with Wafer Fabrication Equipment (WFE) spend expected to be down 15% + in 2019 after a glut in prior years driven by smart phone growth in China. However a product shift appears to be underway with a move to higher densities (more stuff on a wafer ~ 7nm width) and 3G logic and memory chips which effectively will see the Central Processing Unit built directly into the memory. Currently in existing designs, there is a lag, where the CPU issues an instruction and the memory retrieves, reacts and transmits back. If the lag can be overcome then for things like self-driving cars, and gaming, reaction times will be reduced significantly. Consequently 3D is definitely part of any 4th industrial revolution and the required capital expenditure to design and test these new chips will find its way to KLAC.

The stock trades at a forward P/E of 13x or so and has a dividend yield of over 2.5%. The P/E has ranged from 13.5x to as high as 25x so if we see an upswing in WFE spend on the horizon this stock as plenty of upside? Meantime the dividend yield is better than that available on USA and Australian government bonds and certainly than that available in the negative yield cohort!

We like Uber as a consumer but as an investor prefer KLA!



## Overview

The TAMIM Global Equity High Conviction IMA is a portfolio of global equities from major developed global exchanges. The portfolio holds approximately 25 of the best ideas from our investment manager's portfolios. The portfolio uses a systematic and consistent approach to stock selection and portfolio construction to deliver strong risk adjusted returns to our clients while focusing on attempting to preserve their wealth.

## Key Facts

<b>Investment Structure:</b>	Individually Managed Account (only available to wholesale or sophisticated investors)
<b>Minimum investment:</b>	A\$250,000
<b>Pricing &amp; Reporting:</b>	Daily
<b>Investment horizon:</b>	3-5+ years
<b>Management fee:</b>	1.50% p.a.
<b>Expense recovery fee:</b>	Nil
<b>Performance fee:</b>	20% of performance in excess of hurdle
<b>Hurdle:</b>	RBA Cash Rate + 2.5%
<b>Administration fee:</b>	Nil
<b>Exit fee:</b>	1% if exit within 12 months
<b>Single security limit:</b>	10% (typically 2-7%)
<b>Benchmark</b>	MSCI World Index
<b>Target number of holdings:</b>	20-30
<b>Portfolio turnover:</b>	< 25% p.a.
<b>Investable universe:</b>	ASX
<b>Cash level (typical):</b>	0-100% (5-10%)

## Selection of 5 Holdings

Stock	Country
Verizon Communications Inc	USA
Legal & General Group PLC	UK
China Mobile	China
Macy's	USA
Ping An Insurance	China

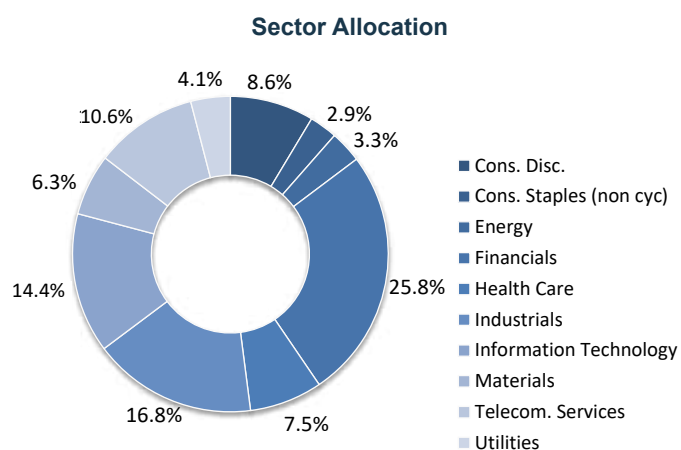
## Returns

	1m	6m	1y	3y (p.a.)	5y (p.a.)	Since inception (p.a.)
<b>TAMIM Glob. High Conv.</b>	3.29%	6.16%	4.88%	9.15%	12.90%	15.54%
<b>MSCI World</b>	4.50%	9.59%	14.19%	14.35%	13.54%	15.06%
<b>Cash</b>	0.12%	0.75%	1.51%	1.53%	1.81%	2.41%

Note: Returns are quoted net of fees and assume dividends are reinvested. Past performance is no guarantee of future performance. TAMIM Glob. High Conv. refers to the performance of the API High Conviction Strategy (Underlying Portfolio). The TAMIM Global Equity High Conviction IMAs mirror the Underlying Portfolio.

## Portfolio Profile

<b>Equities</b>	96.56%
<b>Cash</b>	3.44%



Note: Portfolio returns are quoted net of fees. The ASX 300 refers to the S&P/ASX 300 Accumulation Index. Returns shown for longer than 1 year (other than Inception) are annualised. The information provided in this factsheet is intended for general use only. The information presented does not take into account the investment objectives, financial situation and advisory needs of any particular person nor does the information provided constitute investment advice. Under no circumstances should investments be based solely on the information herein. Please consider our Information Memorandum and Services Guide before investing in any of our products. Past performance is no guarantee of future returns. Returns displayed in this document are unaudited. For wholesale and sophisticated investors only.

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